

ORIGINAL

OPEN MEETING ITEM

COMMISSIONERS
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BOB BURNS
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ARIZONA CORPORATION COMMISSION

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DATE: OCTOBER 7, 2013

AZ CORP COMMISSION
DOCKET CONTROL

DOCKET NOS: W-03514A-13-0111 AND W-03514A-13-0142

TO ALL PARTIES:

Enclosed please find the recommendation of Administrative Law Judge Dwight D. Nodes. The recommendation has been filed in the form of an Opinion and Order on:

PAYSON WATER CO., INC.
(RATES/FINANCE/PHASE 1)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and thirteen (13) copies of the exceptions with the Commission's Docket Control at the address listed below by **4:00 p.m.** on or before:

OCTOBER 10, 2013

Company has waived the 10 days for filing of exceptions

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Working Session and Open Meeting to be held on:

TO BE DETERMINED

For more information, you may contact Docket Control at (602)542-3477 or the Hearing Division at (602)542-4250. For information about the Open Meeting, contact the Executive Director's Office at (602) 542-3931

Arizona Corporation Commission

DOCKETED

OCT 07 2013

DOCKETED BY	
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JODI JERICH
EXECUTIVE DIRECTOR

1200 WEST WASHINGTON STREET; PHOENIX, ARIZONA 85007-2927 / 400 WEST CONGRESS STREET; TUCSON, ARIZONA 85701-1347

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1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 **COMMISSIONERS**

3 BOB STUMP - Chairman
4 GARY PIERCE
5 BRENDA BURNS
6 BOB BURNS
7 SUSAN BITTER SMITH

8 IN THE MATTER OF THE APPLICATION OF
9 PAYSON WATER CO., INC., AN ARIZONA
10 CORPORATION, FOR A DETERMINATION OF
11 THE FAIR VALUE OF ITS UTILITY PLANT AND
12 PROPERTY AND FOR INCREASES IN ITS
13 WATER RATES AND CHARGES FOR UTILITY
14 SERVICE BASED THEREON.

DOCKET NO. W-03514A-13-0111

10 IN THE MATTER OF THE APPLICATION OF
11 PAYSON WATER CO., INC., FOR AUTHORITY
12 TO ISSUE EVIDENCE OF INDEBTEDNESS IN
13 AN AMOUNT NOT TO EXCEED \$1,238,000 IN
14 CONNECTION WITH INFRASTRUCTURE
IMPROVEMENTS TO THE UTILITY SYSTEM;
AND ENCUMBER REAL PROPERTY AND
PLANT AS SECURITY FOR SUCH
INDEBTEDNESS.

DOCKET NO. W-03514A-13-0142

OPINION AND ORDER
(Phase 1)

15 DATE OF HEARING: September 25, 2013

16 PLACE OF HEARING: Phoenix, Arizona

17 ADMINISTRATIVE LAW JUDGE: Dwight D. Nodes

18 APPEARANCES: Mr. Jay Shapiro, FENNEMORE CRAIG, P.C., on
19 behalf of Payson Water Co., Inc.; and

20 Ms. Robin Mitchell, Staff Attorney, Legal Division, on
21 behalf of the Utilities Division of the Arizona
Corporation Commission.

22 **BY THE COMMISSION:**

23 **Procedural History**

24 On April 22, 2013, Payson Water Co., Inc. ("PWC" or "Company") filed with the Arizona
25 Corporation Commission ("Commission") an application in Docket No. W-03514A-13-0111 for a
26 determination of the fair value of its utility plant and property and for increases in its water rates and
27 charges for utility service ("Rate Application").

28 On May 17, 2013, the Commission's Utilities Division ("Staff") issued a Deficiency Letter

1 finding the Rate Application to be deficient in several respects, and requesting certain additional
2 information be provided by the Company.

3 On May 22, 2013, PWC filed revised schedules and other information requested by Staff.

4 On May 27, 2013, PWC filed with the Commission an application in Docket No. W-03514A-
5 13-0142 for authority to (1) issue evidence of indebtedness in an amount not to exceed \$1,238,000 on
6 the terms and conditions set forth by the Water Infrastructure and Finance Authority ("WIFA"), and
7 (2) encumber its real property and utility plant as security for such indebtedness ("Finance
8 Application").

9 On June 3, 2013, Staff issued a Sufficiency Letter finding the Rate Application to be
10 sufficient, and PWC was classified as a Class C utility.

11 On July 2, 2013, a Procedural Order was issued setting the Rate Application for hearing
12 beginning December 9, 2013, establishing other procedural filing dates, and ordering notice by mail
13 and publication.¹

14 On August 15, 2013, PWC filed a Motion to Consolidate Proceedings and Request for
15 Expedited Procedural Schedule. PWC requested that the Rate and Finance Application dockets be
16 consolidated and that a new, expedited procedural schedule be established to enable the Company to
17 pursue an opportunity recently presented by the Town of Payson ("Town" or "Payson") to build the
18 first phase of PWC's planned interconnection between PWC's Mesa del Caballo system and the C.C.
19 Cragin Pipeline ("Cragin Pipeline"). As requested by the Company, if approved, the Phase 1 project
20 would enable PWC's Mesa del Caballo customers to avoid water hauling surcharges as soon as next
21 summer.

22 On August 20, 2013, Staff filed its Response to Motion to Expedite. Staff stated that it did
23 not oppose the consolidation request, but opposed PWC's request to expedite the entire proceeding.
24 Staff proposed that a procedural conference be convened to discuss scheduling.

25 On August 22, 2013, PWC filed a Reply in Support of Motion to Consolidate Proceedings
26 and Request for Expedited Procedural Schedule. The Company stated that the entire consolidated
27

28 ¹ The notice was not mailed or published at that time due to subsequent motions by the Company regarding consolidation with the Finance Application.

1 proceeding should be expedited to afford rate relief in conjunction with commencement of the
2 pipeline project, or that the matter should be bifurcated with expedited consideration of the Finance
3 Application and interim rate relief.

4 By Procedural Order issued August 26, 2013, Docket Nos. W-03514A-13-0111 and W-
5 03514A-13-0142 were consolidated, and a procedural conference was scheduled for September 4,
6 2013.

7 On September 4, 2013, the procedural conference was conducted as scheduled, at which time
8 the parties discussed procedures for processing the consolidated cases.

9 On September 5, 2013, PWC filed a Stipulation for Procedural Order Bifurcating Proceeding
10 and Establishing Case Schedule. In the stipulation, PWC and Staff proposed to proceed in two
11 phases, with a Phase 1 hearing regarding a portion of the Finance Application commencing on
12 September 25, 2013, and a Phase 2 hearing on the Rate Application and the balance of the Finance
13 Application beginning on January 13, 2014. Other procedural dates were also listed and a proposed
14 customer notice was attached to the filing.

15 On September 10, 2013, a Procedural Order was issued setting a revised procedural schedule
16 for consideration of the Rate and Finance Applications. An expedited hearing on "Phase 1" was
17 scheduled for September 25, 2013, to consider the Company's request for approval of a \$275,000
18 WIFA loan to finance a portion of the planned interconnection to the Cragin Pipeline that would
19 enable the Company to interconnect the Mesa del Caballo system to the Town of Payson, so that
20 water could be obtained directly from the Town rather than having to haul water by truck during
21 periods of water shortages. The hearing on the Rate Application and remainder of the proposed
22 WIFA loan ("Phase 2") was scheduled to commence on January 13, 2014, and other testimony filing
23 deadlines were established. The Company was also directed to mail and publish notice of the
24 proceedings to customers.

25 On September 18, 2013, Staff filed a Staff Report in Phase 1, recommending approval of the
26 \$275,000 expedited WIFA loan, subject to certain conditions.

27 On September 23, 2013, PWC filed the responsive testimony of Jason Williamson and
28 Thomas Bourassa.

On September 25, 2013, the Phase 1 hearing was held as scheduled. At the beginning of the hearing, public comment was received from various customers of PWC expressing opposition to the requested rate increases.² The hearing concluded on September 25, 2013, subject to the Company being required to submit certain late-filed exhibits.

On October 1, 2013, PWC late-filed: a 2009 report on Water Supply Alternatives for the Mesa del Caballo system; a 2010 audio-frequency magnetotelluric survey performed by Zonge Engineering and Research Organization, Inc. ("Zonge") for Mesa del Caballo; and a 2010 report by Southwest Groundwater Consultants regarding the implications of the Zonge study.

* * * * *

Having considered the entire record herein and being fully advised in the premises, the Commission finds, concludes, and orders that:

FINDINGS OF FACT

Phase 1 Finance Request

1. PWC is an Arizona public service corporation that currently provides water utility service to approximately 1,114 customers in Gila County, Arizona. According to its Rate Application, during the 2012 test year the Company served 83 customers in its Geronimo Estates system; 121 customers in the Deer Creek system; 69 customers in the Meads Ranch system; 146 customers in the Whispering Pines system; 29 customers in the Flowing Springs system; 162 customers in the Gisela/TCS system; 385 customers in the Star Valley/Quail Valley system;³

² During public comment at the beginning of the hearing, as well as through subsequent written comments, several customers expressed concern with the timing of the notice and hearing for the expedited Phase 1 proceeding and suggested that the Commission's procedural rules were violated, pursuant to Arizona Administrative Code ("A.A.C.") R14-3-208, which they assert requires 30 days notice prior to the Commission holding a hearing. However, the rule cited by these customers applies to hearings conducted by the Arizona Power Plant and Transmission Line Siting Committee, not the Arizona Corporation Commission. The applicable rule for Commission proceedings is A.A.C. R14-3-109, which states that 10 days notice is to be given prior to a hearing "unless otherwise provided by law or as ordered by the Commission." In this case, as is discussed below, the WIFA deadline for financing approval by the Commission necessitated the scheduling of an expedited hearing in this matter in order for the first phase of the pipeline project to be completed by the summer of 2014 – to enable PWC to deliver water directly from the Town of Payson and avoid the expensive water hauling charges that have been assessed to Mesa del Caballo customers in prior years. Further, contrary to the concerns expressed by certain customers located in other systems outside Mesa del Caballo, PWC's financing request for the Cragin pipeline, including the expedited Phase 1 request for the Payson interconnection, will affect only customers in the Mesa del Caballo system and not customers in other PWC systems.

³ In May 2012, the Town of Star Valley acquired all of the infrastructure and customers of the Star Valley/Quail Valley system through condemnation. Therefore, PWC no longer owns or operates that system.

1 customers in the East Verde Park Estates system; and 364 customers in the Mesa del Caballo system.

2 2. The Company's current rates and charges were established in Decision Nos. 62320
3 (February 17, 2000) and 62401 (March 30, 2000), based on a 1998 test year. The only subsequent
4 rate change was approved in Decision No. 71902 (September 28, 2010) for a water augmentation
5 surcharge to recover water hauling costs incurred for the Mesa del Caballo system.

6 3. According to the Company's testimony in this case, on May 31, 2013, JW Water
7 Holdings, LLC ("JW Water") acquired PWC, Tonto Basin Water, and Navajo Water from Brooke
8 Utilities, Inc. As of June 1, 2013, PWC is owned and operated by JW Water. Jason Williamson is
9 the manager of PWC. (Ex. A-1, at 1.)⁴

10 4. As described above, PWC's Rate Application and Finance Application have been
11 consolidated and are scheduled for hearing beginning January 13, 2014. (See September 10, 2013
12 Procedural Order.) In its Finance Application, the Company is requesting authority to obtain a WIFA
13 loan in the amount of \$1,238,000 to fund an interconnection of the Mesa del Caballo system to the
14 planned Cragin Pipeline that will be constructed to bring water to the Town of Payson from a Salt
15 River Project ("SRP") reservoir. The Cragin Pipeline is expected to be completed by 2016.

16 5. On August 15, 2013, PWC filed a Motion to Consolidate Proceedings and Request for
17 Expedited Procedural Schedule. In testimony attached to PWC's Motion, Mr. Williamson claimed
18 that the Mesa del Caballo subdivision and system are located on a solid rock outcropping that makes
19 drilling wells there "a very risky (and expensive) proposition." (Ex. A-1, at 4.) He stated that many
20 wells in the area are unpredictable, especially during summer months, and therefore the Company has
21 been forced to use trucks to haul water from the Town of Payson during the summer to keep up with
22 demand. Mesa del Caballo customers are assessed a surcharge to recover the hauling costs incurred
23 by PWC, pursuant to a Water Augmentation Surcharge tariff. (*Id.*)

24 6. As described by Mr. Williamson, the Cragin Pipeline project is being spearheaded by
25 Payson to bring water to the Town from SRP's Cragin Reservoir, which is located approximately 25
26 miles northeast of Payson. (*Id.*) He stated that the pipeline route, as well as the Town's new water

27 _____
28 ⁴ Mr. Williamson is also affiliated with Pivotal Utility Management, LLC ("Pivotal"), which operates ten water and
wastewater utilities, eight of which are located in Arizona. (*Id.*)

1 treatment system, are located "literally across the street from Mesa del Caballo." (*Id.* at 5.) Mr.
2 Williamson indicated that PWC's agreement with the Town and SRP would allow the Company to
3 interconnect to the Cragin Pipeline and give PWC up to 72 acre-feet of renewable water per year.
4 (*Id.*)

5 7. According to Mr. Williamson, he met with representatives of Payson shortly after he
6 purchased PWC to discuss the Cragin Pipeline. He testified that although the full pipeline is not
7 expected to be completed until September 2016, PWC was informed that the Town had changed its
8 plans and "decided to build the section of the pipeline that runs from the current Town water
9 distribution system to Mesa del Caballo (about 3.5 miles) now." (*Id.*) Mr. Williamson stated that,
10 according to the Town's engineers, although the Cragin Pipeline is designed to bring water from the
11 reservoir to Payson when it is completed, in the meantime the pipeline could function in the opposite
12 direction to deliver water from Payson's storage facilities to Mesa del Caballo. He indicated that the
13 Town is hoping that PWC will build this first phase of the interconnection to bring water from the
14 Town to Mesa del Caballo by May 2014. (*Id.*) Mr. Williamson indicated that such an interconnection
15 would enable PWC to avoid the hauling surcharges over the next two summers in advance of
16 completion of the full pipeline project, and thereby save Mesa del Caballo customers from the
17 substantial costs associated with hauling water by trucks. (*Id.*)

18 8. Mr. Williamson further explained that there are two segments to construction of this
19 initial "TOP-MDC" (*i.e.*, Town of Payson - Mesa del Caballo) line. The first section is being
20 constructed by the Town to connect its distribution system to its treatment plant, located adjacent to
21 Mesa del Caballo; and the second section, which would be built by PWC, would be comprised of a
22 pipeline crossing Houston Mesa Road from the termination of the Town's line to the Mesa del
23 Caballo system's main storage facilities. (*Id.* at 6.) Mr. Williamson claimed that construction of the
24 Company's portion of the line would take between 8 and 12 weeks. (*Id.*)

25 9. Mr. Williamson stated that the Company has a pre-authorization from WIFA for the
26 financing of PWC's portion of the Cragin Pipeline project (\$1,238,000), but that an initial \$275,000
27 of the financing would be drawn down in a first phase so that PWC could take advantage of the
28 opportunity offered by the Town to avoid water hauling as early as next summer. (*Id.* at 7.) He

1 indicated that JW Water purchased PWC with the expectation that the Cragin Pipeline project would
2 be financed through a WIFA loan, and the Company does not currently have adequate earnings to
3 finance the pipeline without such a loan. (*Id.* at 8.)

4 10. In its Staff Report filed on September 18, 2013, Staff recommended approval of
5 PWC's expedited request to borrow up to \$275,000 from WIFA for the purpose of financing the
6 TOP-MDC pipeline, subject to certain conditions. As set forth in the Staff Report, those conditions
7 are as follows:

8 11. In the Staff Report, Staff discussed the history of the Mesa del Caballo system and the
9 frustration experienced by customers with the water augmentation surcharges during the summer
10 months. (Ex. S-2, at 2.) Staff attached redacted customer bills showing, for example, that one
11 customer's bill was \$131.86 for usage of 4,460 gallons in June 2013, of which approximately 75
12 percent was attributable to the augmentation surcharge. (*Id.* at 1.) Staff pointed out that it has
13 processed several informal complaints from MDC customers related to the surcharge, and Staff
14 believes that expedited approval of the Phase 1 financing request is justified because it will mitigate
15 much of the burden experienced by Mesa del Caballo customers during the summer months. (*Id.* at 1-
16 2.)
17

18 12. Staff's Engineering Report found the estimated Phase 1 costs of building the TOP-
19 MDC pipeline (approximately \$275,000) to be "reasonable and appropriate," although Staff stated
20 that no "used and useful" determination of the proposed plant items was made, and no inference
21 should be drawn regarding future ratemaking treatment of the pipeline facilities. (Ex. S-2, Eng. Rep.
22 at 2.) Staff stated that in order to enable PWC to demonstrate the necessary financial capability to
23 support the \$275,000 WIFA loan, a new WIFA loan surcharge should be approved for the Company.
24 Staff's analysis of the Phase 1 portion of the financing request resulted in a recommendation that the
25 Phase 1 surcharge should be set at a level that would enable the Company to recover the monthly
26 payments of principal, interest and fees, and the debt service reserve required by WIFA (20 percent
27
28

1 of the loan). (Ex. S-2, at 2.) Staff further recommended that PWC be required to keep the loan
2 surcharge proceeds in a segregated account to be used solely for making payments on the WIFA loan.
3 (*Id.*)

4 13. Addressing the need for expedited consideration of the Phase 1 request, Staff stated
5 that in order for PWC to receive financing from WIFA by the end of the year, the Company must
6 submit its loan application by October 25, 2013. According to Staff, WIFA has advised that PWC's
7 financial capability would be enhanced if the Commission would commit to completing the
8 Company's permanent rate case by the end of 2014, and provide rates sufficient to achieve a DSC of
9 1.2 or greater. (*Id.* at 3.) Staff also recommends approval of a purchased water adjustor for PWC, on
10 an interim basis in Phase 1, to enable the Company to recover the cost of water purchased from the
11 Town of Payson through the proposed pipeline. (*Id.*) Staff's proposed purchased water adjustor is
12 attached to the Staff Report.
13

14 14. Because the Commission is being asked in Phase 1 to approve a WIFA loan surcharge
15 and purchased water adjustor surcharge mechanism prior to a decision in PWC's permanent rate case,
16 the parties were directed in the September 10, 2013, Procedural Order to "address [in Phase 1] the
17 requirements for granting interim rate relief under Arizona law." (September 10, 2013, Procedural
18 Order, at 3.) Citing *Scates v. Arizona Corporation Comm'n*, 118 Ariz. 531, 578 P.2d 612 (App.
19 1978), Staff defined interim rates as "rates charged by a utility for services or products pending the
20 establishment of a permanent rate, in emergency situations or where a bond is posted that guarantees
21 a refund to consumers for any excess paid [by] them prior to the Commission's final determination."
22 (Ex. S-2, at 3.) Staff stated that the conditions generally necessary for the imposition of interim,
23 emergency rates include: a sudden change that causes hardship to a company; company insolvency;
24 and where a company's ability to maintain service (pending a determination of permanent rates) is in
25 serious doubt. (*Id.*, citing Arizona Attorney General Opinion No. 71-17 (1971).)
26
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1 15. Staff asserts that approval of interim rates, through the WIFA loan surcharge and
2 purchased water adjustor, is justified in this case given the substantial rate increases experienced by
3 Mesa del Caballo customers over the last two summers associated with water hauling. (Ex. S-2, at 3.)
4 The Commission approved the water augmentation surcharge in Decision No. 71902 because of
5 chronic summer shortages in the MDC system and demand that exceeds the Company's well
6 capacity. (Decision No. 71902 (September 28, 2010), at 10.) Therefore, according to Staff, the
7 opportunity to mitigate the burden on ratepayers prior to next summer "is an exigent circumstance
8 that warrants the extraordinary relief requested by the Company and supported by Staff." (Ex. S-2, at
9 3.) Staff points out that the interim rate safeguards will be observed in this Phase 1 proceeding
10 because, if Staff's recommendations are adopted: PWC currently has a permanent rate case pending;
11 the proposed surcharge will be reviewed in the permanent rate case proceeding; and the Company
12 will be required to post a \$10,000 bond, which Staff claims represents approximately 6 months of
13 PWC's revenues. (*Id.* at 4.)

14
15 16. With respect to the proposed Phase 1 WIFA loan surcharge, Staff indicated that it
16 should be applied only to Mesa del Caballo customers because the TOP-MDC pipeline, and
17 elimination of the Water Augmentation Surcharge, would primarily benefit those customers. (*Id.*)
18 According to Staff, the proposed Phase 1 \$275,000 WIFA loan will have a 20-year term, with a 4.99
19 percent interest rate. The monthly payments are estimated to be \$1,815, or \$21,779 annually, which
20 includes a provision for income taxes and a debt reserve deposit, as required by WIFA. (*Id.*) As
21 shown in Schedule CSB-1 of the Staff Report, the Phase 1 WIFA loan surcharge would be
22 approximately \$7.44 per month for customers in the Mesa del Caballo system. Staff recommends
23 that PWC be authorized to begin collecting the surcharge in the first month following Commission
24 approval of the Phase 1 WIFA loan. (*Id.*) The full list of Staff's recommendations is as follows:
25
26

- 27 • Approval of the Company's request to borrow up to \$275,000 from
28 WIFA for the purpose of financing the construction of a new water

transmission line to connect its MDC system to the Town of Payson's water system.

- Approval of a WIFA Loan Surcharge mechanism that may result in a surcharge of \$7.44 per month per MDC customer.
- The immediate elimination of the Emergency Interim Water Augmentation Surcharge Tariff ("Augmentation Tariff") that is currently in effect for PWC's MDC system.
- That the WIFA Loan Surcharge apply only to customers of the MDC system.
- That the amount of the WIFA Loan Surcharge be calculated based upon the actual amount of the WIFA loan and actual number of customers in the MDC system.
- That the Company file with the Commission a WIFA loan surcharge tariff that would enable the Company to meet its principal, interest, debt reserve, and tax obligations on the proposed WIFA loan.
- That the Company follow the same methodology presented on Schedule CSB-1 of the Staff Report to calculate the additional revenue needed to meet its principal, interest, debt reserve, and tax obligations on the proposed WIFA loan using actual loan amounts and customer counts.
- That the Company make a WIFA loan surcharge filing within 15 days of the loan closing.
- That the Company record the WIFA loan surcharge proceeds as Contributions in Aid of Construction ("CIAC").⁵
- That the Company place the WIFA loan surcharge proceeds in a segregated account, to be used only for making payments on the WIFA loan.
- That the Commission affirm in the Phase 1 Order its intent to process PWC's pending rate case prior to the end of 2014, with a final Decision resulting in a debt service coverage ("DSC") ratio of 1.2 or greater for the resulting WIFA loan approval.
- That the Commission approve a new Purchased Water Adjustor, which was included as an attachment to the Staff Report, to allow for the purchase of water from the Town of Payson.

⁵ At the hearing, Staff witness Crystal Brown modified this condition to require that the Company be required to record only the debt reserve component of the loan proceeds as CIAC. (Tr. 113-114.)

- That the Company be required to post a bond or irrevocable letter of credit in the amount of \$10,000 prior to the implementation of the WIFA Loan Surcharge and Purchased Water Adjustor Surcharge authorized in Phase 1.
- That the Company notify the MDC customers of the elimination of the Water Augmentation Surcharge and the creation of the WIFA Loan Surcharge and Purchased Water Adjustor by means of a bill insert in the next regularly scheduled billing after the Commission's Decision in Phase 1 of this proceeding. (Ex. S-2, at 4-5.)

17. In its responsive testimony, PWC agreed with most of the conditions recommended by Staff, with two exceptions. Mr. Williamson expressed concern with Staff's recommendation to eliminate immediately the current Water Augmentation Surcharge tariff, and with Staff's recommendation that the Company be required to record the WIFA loan surcharge proceeds as contributions in aid of construction ("CIAC"). (Ex. A-2, at 3-5.) Instead of eliminating the augmentation tariff immediately, the Company suggested amending Staff's proposed purchased water tariff to allow water hauling surcharges to resume if water from the Cragin Pipeline became unavailable. (*Id.* at 5.)⁶ With the Company's agreement to eliminate the augmentation tariff, and for deferral of the purchased water tariff to Phase 2, PWC's only remaining dispute is with Staff's recommended accounting treatment of the loan proceeds.

18. Although Staff modified its recommendation at the hearing to require that only the debt reserve portion of the WIFA loan be treated as CIAC, Company witness Bourassa testified that no part of the loan surcharge proceeds should be treated as CIAC. He stated that Staff's recommendation would "have the unintended consequence of depriving the Company of the ability to fully recover its investment and its cost of capital on that investment in the future." (Ex. A-3, at 3-4.) According to Mr. Bourassa, under Staff's recommendation, PWC's rate base would be reduced by the

⁶ During the hearing, PWC agreed with Staff's recommendation to eliminate immediately the Water Augmentation Surcharge tariff, subject to having the ability to request relief from the Commission in the event of an emergency that arises prior to completion of the TOP-MDC pipeline. The Company also agreed that a decision regarding Staff's purchased water surcharge tariff could be delayed until the permanent rate case proceeding (Phase 2). (Tr. 145-146.)

1 amount recorded as CIAC, which would lead to lower earnings than are necessary to cover capital
2 costs and to lower depreciation recovery. (Id. at 4.)

3 **Discussion and Resolution**

4 19. We have undertaken an expedited consideration of Phase 1 of PWC's Finance
5 Application at the request of both the Company and Staff, due to the unique opportunity that was
6 presented to PWC by the Town of Payson regarding the availability of an interconnection with the
7 Town's system that could reduce substantially the summer water bills for customers located in Mesa
8 del Caballo. In undertaking this Phase 1 review, we wish to make clear that we are not making any
9 determination as to the future used and usefulness or ratemaking treatment for the proposed TOP-
10 MDC pipeline. Rather, as is the case in all financing applications, we are considering only the
11 reasonableness of the loan request in the context of whether it: is for lawful purposes, within the
12 Company's corporate powers, and is able to be repaid under reasonable terms and conditions.
13

14 20. In its Staff Report, Staff calculated the cost of the \$275,000 Phase 1 loan request,
15 including interest, taxes, and WIFA's debt reserve requirement, and determined that Mesa del
16 Caballo customers would be required to pay a monthly surcharge of approximately \$7.44 for the
17 Phase 1 interconnection with Payson's system. Since this initial interconnection would need to be
18 built as part of the overall Cragin Pipeline project, the Phase 1 interconnection represents an
19 expedited partial element of the planned construction costs. The remainder of PWC's Finance
20 Application will be considered as part of the consolidated rate/financing proceeding that is scheduled
21 for hearing in January 2014, and we make no conclusions regarding those matters at this time.
22

23 21. The following statutes provide guidance regarding the Commission's review of
24 financing applications:
25

26 A.R.S §40-285(A) provides, in relevant part:

27 A public service corporation shall not sell, lease, assign, mortgage or
28 otherwise dispose of or encumber the whole or any part of its railroad,

1 line, plant, or system necessary or useful in the performance of its duties
2 to the public, or any franchise or permit or any right thereunder, nor shall
3 such corporation merge such system or any part thereof with any other
4 public service corporation without first having secured from the
5 commission an order authorizing it to do so.

6 A.R.S. §40-302(A) provides, in part, that:

7 Before a public service corporation issues stocks and stock certificates,
8 bonds, notes and other evidences of indebtedness, it shall first secure from
9 the commission an order authorizing such issue and stating the amount
10 thereof, the purposes to which the issue or proceeds thereof are to be
11 applied, and that, in the opinion of the commission, the issue is reasonably
12 necessary or appropriate for the purposes specified in the order...and that,
13 except as otherwise permitted in the order, such purposes are not, wholly
14 or in part, reasonably chargeable to operative expenses or to income.

15 22. Based on our review of the facts and circumstances presented in this limited Phase 1
16 financing request, we find that that the application satisfies these standards because: PWC reasonably
17 needs approval of the financing to pursue the project; the TOP-MDC interconnection is for a lawful
18 purpose, is within the Company's corporate powers, and is a proper function of a public water utility;
19 financing of the Phase 1 project is within PWC's proper performance as a public service corporation,
20 especially given the Commission's prior admonishments to the Company to seek additional water
21 sources and the current imposition of augmentation surcharges imposed on MDC customers; and the
22 project will not impair PWC's ability to serve its customers. Given these factors, we conclude that
23 the proposed Phase 1 financing arrangement is in the public interest and should be approved.

24 23. In reaching this conclusion we agree with the Company and Staff that the issues
25 presented for our review are relatively narrow. Consistent with a long line of decisions addressing
26 financing applications, our review of such requests is generally limited to a determination of whether
27 the requested financing is for a lawful purpose, consistent with sound financial practices, compatible
28 with the public interest and the applicant's proper performance as a public service corporation, and is
within the applicant's corporate powers; whether the applicant's revenues are adequate to support its
repayment obligations; and whether the financing will impair its ability to provide service to its
customers.

29 24. Because the Phase 1 finance request includes a recommendation for a loan surcharge,

1 we must also consider whether the request satisfies the requirements for approval of interim rates.
2 Based on the facts and circumstances presented, we find that the proposed Phase 1 WIFA loan
3 surcharge is in the public interest, and satisfies the interim rate requirements because: PWC has a
4 permanent rate case pending, as well as a financing application for the remainder of the Cragin
5 Pipeline project; PWC will be required to post a \$10,000 bond as a condition of surcharge approval,
6 which would provide a guarantee for a refund to customers of any excess amounts paid by them prior
7 to a final determination in the permanent rate case; and the financing and surcharge are essential to
8 the Company's ability to pursue, on an expedited basis, an immediate resolution to the substantial rate
9 burdens experienced by Mesa del Caballo customers in recent years when, on an emergency basis,
10 PWC has needed to haul water. We also note that the existing Water Augmentation Surcharge tariff
11 will be replaced by a much less expensive WIFA loan surcharge tariff. Taken in their totality, we
12 believe Staff's recommended conditions (subject to the modification discussed below) satisfy the
13 necessary elements for the Phase 1 financing approval and associated WIFA loan surcharge.

14 25. The only remaining disputed issue between PWC and Staff involves the accounting
15 treatment to be accorded the Phase 1 loan surcharge proceeds. As described above, Staff
16 recommends that the debt reserve portion of the WIFA loan proceeds be recorded as CIAC, while
17 PWC contends that no part of those surcharge proceeds should be treated as CIAC. We believe that a
18 different accounting treatment is appropriate in this instance that will still give recognition to the
19 customer contribution aspect of the debt reserve funds.

20 26. The normal components of a company's cost of service are capital investment costs,
21 operating and maintenance expenses, depreciation expense, and taxes. However, because the debt
22 service reserve funds that will be paid by customers through the surcharge (due to WIFA's
23 requirement) are not an element of PWC's cost of service, those monies are not revenues available for
24 the benefit of the Company. Rather, the monies paid by customers that are attributable to the debt
25 reserve portion of the WIFA loan surcharge represent advances by customers to which they are
26 entitled to receive recognition through a refund, amortization against expenses, or other
27 compensation, as may be determined by the Commission in the future. We will therefore, in
28 accordance with the National Association of Regulatory Utility Commissioners Uniform System of

1 Accounts ("NARUC USoA") Account No. 253, direct PWC to track and separately record as a
2 regulatory liability, the surcharge proceeds associated with the debt service reserve fund. PWC
3 should maintain an accurate balance of the regulatory liability until its obligation to ratepayers is
4 completely satisfied.

5 **CONCLUSIONS OF LAW**

6 1. PWC is a public service corporation within the meaning of Article XV of the Arizona
7 Constitution and A.R.S. §§ 40-250, 40-285, 40-301, 40-302, and 40-303.

8 2. The Commission has jurisdiction over PWC and of the subject matter of the Rate and
9 Finance Applications.

10 3. Notice of the Rate and Finance Applications was given in accordance with the
11 September 10, 2013 Procedural Order, the Commission's rules, and Arizona law.

12 4. The authorizations granted herein are for lawful purposes which are within the
13 corporate powers of PWC, are compatible with the public interest, with sound financial practices, and
14 with the proper performance by PWC of service as a public service corporation, and will not impair
15 PWC's ability to perform that service.

16 5. The authorizations granted herein are reasonably necessary or appropriate for the
17 purposes.

18 6. The interim rates represented by the Phase 1 WIFA loan surcharge are reasonable and
19 in the public interest because PWC has a pending permanent rate case pending, as well as a financing
20 application for the remainder of the Cragin Pipeline project; PWC will be required to post a \$10,000
21 bond as a condition of surcharge approval, which would provide a guarantee for a refund to
22 customers of any excess amounts paid by them prior to a final determination in the permanent rate
23 case; and the financing and surcharge are essential to the Company's ability to pursue, on an
24 expedited basis, an immediate resolution to the substantial rate burdens experienced by Mesa del
25 Caballo customers in recent years when PWC has needed to haul water.

26 **ORDER**

27 IT IS THEREFORE ORDERED that Payson Water Co., Inc. is hereby authorized to borrow
28 up to \$275,000 from WIFA, under the terms and conditions set forth in the Staff Report, as modified,

1 for the purpose of financing the construction of a new water transmission line to connect its Mesa del
2 Caballo system to the Town of Payson's water system.

3 IT IS FURTHER ORDERED that such finance authority shall be expressly contingent upon
4 Payson Water Co., Inc.'s use of the proceeds for the purposes stated in its Phase 1 financing request
5 and approved herein.

6 IT IS FURTHER ORDERED that Payson Water Co., Inc. may engage in any transaction and
7 to execute any documents necessary to effectuate the authorizations granted herein.

8 IT IS FURTHER ORDERED that approval of the financing set forth herein does not
9 constitute or imply approval or disapproval by the Commission of any particular expenditure of the
10 proceeds derived thereby for purposes of establishing just and reasonable rates.

11 IT IS FURTHER ORDERED that Payson Water Co., Inc. shall provide the Utilities Division
12 Compliance Section a copy of any loan documents executed pursuant to the authorizations granted
13 herein, within 30 days of the execution of the loan, and shall file with Docket Control, as a
14 compliance item in this Docket, a letter verifying that such documents have been provided to the
15 Utilities Division.

16 IT IS FURTHER ORDERED that Payson Water Co., Inc. shall be authorized to implement a
17 WIFA loan surcharge mechanism for its Mesa del Caballo system based on the same methodology
18 presented on Schedule CSB-1 of the Staff Report to calculate the additional revenue needed to meet
19 its principal, interest, debt reserve, and tax obligations on the proposed WIFA loan using actual loan
20 amounts and customer counts.

21 IT IS FURTHER ORDERED that Payson Water Co., Inc. shall make the WIFA loan
22 surcharge filing within 15 days of the Phase 1 loan closing. The surcharge shall apply only to
23 customers of the Mesa del Caballo system and shall be calculated based upon the actual amount of
24 the WIFA loan and actual number of customers in the Mesa del Caballo system.

25 IT IS FURTHER ORDERED that Payson Water Co., Inc. shall file within 15 days of closing
26 of the Phase 1 WIFA loan authorized herein, an application for elimination of the Emergency Interim
27 Water Augmentation Surcharge Tariff that is currently in effect for PWC's Mesa del Caballo system.
28

1 IT IS FURTHER ORDERED that Payson Water Co., Inc. shall notify the Mesa del Caballo
2 customers of the elimination of the Water Augmentation Surcharge and the creation of the WIFA
3 loan surcharge by means of a bill insert in the next regularly scheduled billing after the effective date
4 of this Decision, in a form and manner acceptable to Staff.

5 IT IS FURTHER ORDERED that Payson Water Co., Inc. shall, pursuant to NARUC USoA
6 Account No. 253, track and separately record as a regulatory liability the surcharge proceeds
7 associated with the debt service reserve fund. PWC should maintain an accurate balance of the
8 regulatory liability until its obligation to ratepayers is completely satisfied.

9 IT IS FURTHER ORDERED that Payson Water Co., Inc. shall place the WIFA loan
10 surcharge proceeds in a segregated account, to be used only for making payments on the WIFA loan.

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IT IS FURTHER ORDERED that Payson Water Co., Inc. shall be required to post a bond or irrevocable sight draft letter of credit in the amount of \$10,000 prior to the implementation of the Phase 1 WIFA loan surcharge, in a form acceptable to Staff. The original Performance Bond or Letter of Credit shall be submitted to the Commission's Business Office, with copies of the Bond or Letter filed with Docket Control, as a compliance item in this docket, within 30 days of the effective date of this Decision. The Commission may use the Performance Bond or Letter of Credit funds, as appropriate, to protect the Company's customers and the public interest and take any and all actions the Commission deems necessary, in its discretion. The Performance Bonds or Letters of Credit shall be maintained and copies of the same filed annually on the anniversary date of the initial filing until further Order of the Commission or ten years have passed, whichever is sooner, at which time the Performance Bond or Letter of Credit requirement may be terminated upon approval of the Company's application for termination.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN

COMMISSIONER

COMMISSIONER

COMMISSIONER

COMMISSIONER

IN WITNESS WHEREOF, I, JODI JERICH, Executive Director of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this _____ day of _____ 2013.

JODI JERICH
EXECUTIVE DIRECTOR

DISSENT _____

DISSENT _____

DDN:dp

1 SERVICE LIST FOR: PAYSON WATER CO., INC.
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